

# A NEW HOUSING BOOM





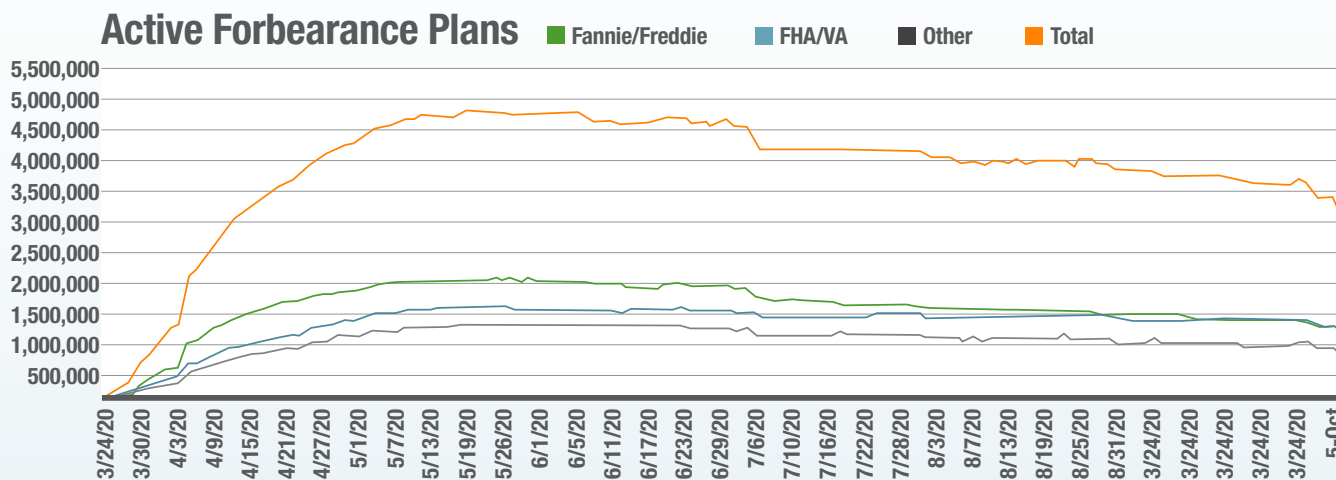
Photo by Kevin Bergen

Last month I spent a lot of time thinking about the American Dream. I got interested in the subject because of what I saw happening in the housing market. Right at the start of the summer, when the initial shelter-in-place orders were coming to an end, I started getting a lot of calls from friends and friends-of-friends looking for help and guidance. The request was always the same: “I/We want to buy a house and we want to do it right now! What do you think, is now a good time? Can you help?” Here in Los Angeles, a very high-cost housing market, it’s not uncommon to see people waiting until their late 30’s or even early 40’s before building up enough financial resources to become a homeowner. What was really interesting about these calls is that I got the clear sense that people were starting to approach the homeownership question from a very different perspective, something really that I haven’t seen since before the housing bubble crash a decade ago. The attitude was:

“We really, really want to own a home, right now. We are not content nor willing to wait and will do whatever it takes to make it happen—even if that means stretching financially, even if that means asking our parents for help! Literally whatever it takes.”

After a few of these calls I knew something was up.

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When the crisis first hit we saw this immediate spike in loans in forbearance and my first instinct was to think that this was a huge negative for the housing market and that we'd eventually see some kind serious market disruption as a result. But what I didn't understand at the beginning of pandemic—that I do know—is how impactful the shelter-in-place orders and the lockdowns would be in changing the way people think and feel about housing. The psychological consequences are real.

The COVID crisis unleashed a new attitude about housing in America. It woke-up the appetites for home ownership from the long hang-over of the bubble. Once again Americans are approaching the housing market with that dreamlike fever that has so characterized our history.

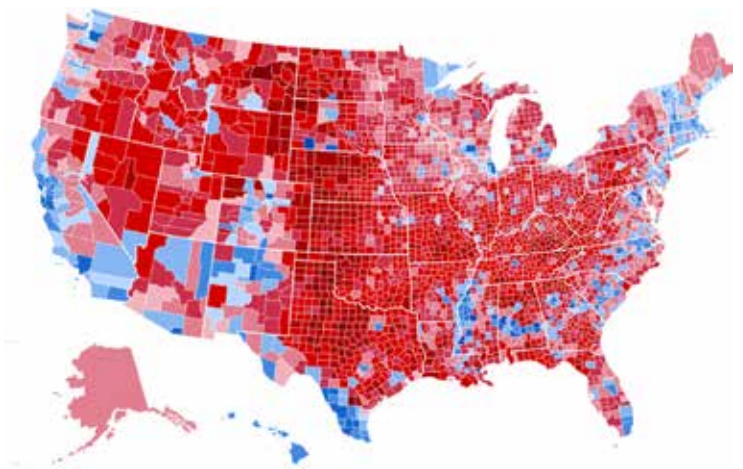
What 10-years of economic expansion couldn't do, 2-months of lockdowns did. COVID brought the housing market back from the dead. Not only are people are willing to bear the risks and costs associated with homeownership, people are willing to move to new neighborhoods, new states, even the dreaded suburbs! There's even a fair bit of risk seeking behavior in the market—nothing near as extreme as during the bubble but there nonetheless and worth paying attention to. This is most prevalent in the neighborhoods that are perceived as ideal places to live in the event of another lockdown—for example, big sky country or Malibu or nice rural vacation markets outside of big cities.

This psychological shift is something I can really relate to and understand. I was fortunate to move our family into a new home just 4 or 5 months before the COVID crisis. We are beyond grateful that the timing worked out this way for us. Like many young families in Los Angeles, we were living in a place way too small for a family of 4. We had no real outdoor space. No place to work. And no chance at all for privacy! Just the thought of spending a few months of lockdown there with our two boys (both under 5!) makes me shudder a bit.

The point is: Where you live really matters. That's what we all re-realized as a result of COVID. Not just your neighborhood, the actual, intimate details of your living situation. How the space in your house flows. How sound travels. The functionality of the room configuration. All the things those of us in the real estate business usually nerd-out about are now in the forefront of our consciousness. Everyone is suddenly really focused on this stuff.

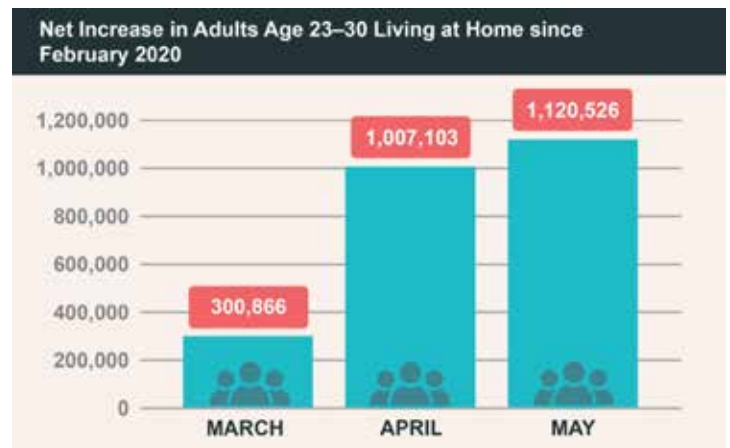
Ok, so what does this all mean? This psychological shift has the potential to impact not only the economy and the market but also our political landscape. It's really important where and how far this new demand for housing goes. The potential is there for a dramatic reordering our society. Large urban centers are these incredibly strong concentrations of power for the Democratic Party. The voting results by county from the

2016 Presidential election demonstrate the point:



Pretty stark divide. Remember: Hillary Clinton managed to win the popular vote. If Democrats were to disperse from these cities in large numbers it could change the election dynamic of the cities themselves and possibly even in places like Utah, Nevada, Texas and the Southeast where these out-migrants are likely to end up.

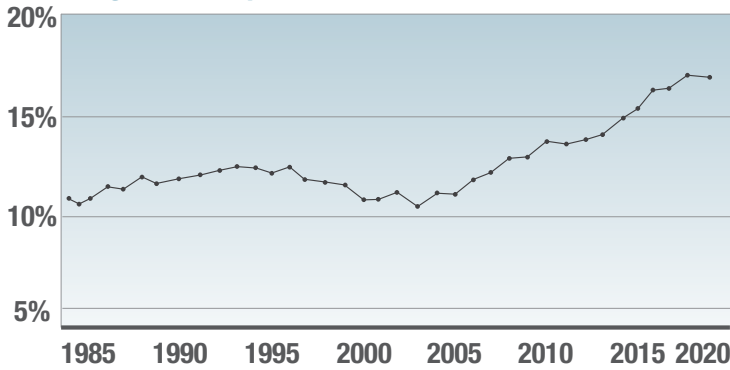
Let's talk about migration for a second. This is a topic that has been making a lot of sensational headlines of late. The dominant narrative out there today is that the COVID crisis has somehow permanently changed the way we think about living in cities. Supposedly "New York is dead!" and never coming back. What's interesting is that what's behind these sensationalized headlines is something that's actually true and important: one of the things that happened to the big cities right at the start of the crisis is that a whole bunch of young people moved home.



Take yourself back to the pre-COVID world. Think of all the young people in a New York or a Los Angeles: the restaurant workers, the aspiring actors and actresses, even the young college graduates.... These are people who were all living or even co-living in tight, overly expensive quarters. To me it makes complete sense that they would leave cities in lockdown. The real question is: will they come back?

What the stories are ignoring completely is that this dynamic—of young people making the decision to live with their parents—has been a trend for years already.

**The percentage of American 25-to-34-year-olds living with their parents, 1983-2019**



It’s really a lingering aftershock of the bubble, both psychologically—in the form of this fear associated with homeownership that I mentioned above—and financially—young people not making enough money or having too much student loan debt or both! The point here is that in the pre-COVID days, even with this decade-long trend firmly in place, the cities were still attracting enough young people to keep their populations growing or at worst stable.

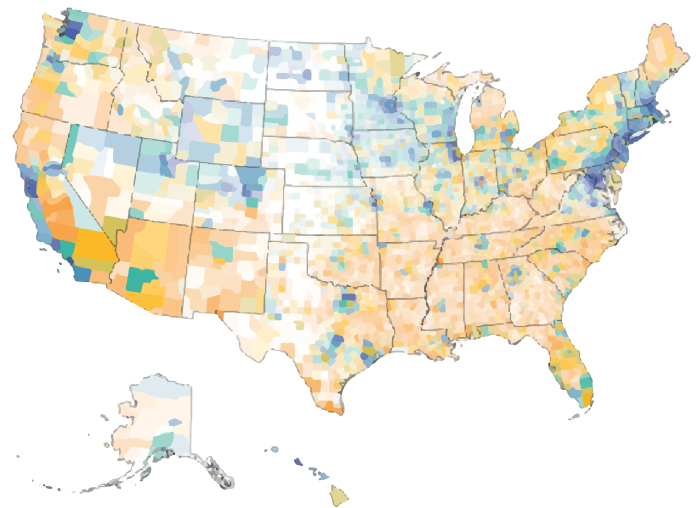
The other narrative that has captured a lot of attention is this one of high-profile celebrities and public figures leaving cities “forever”, often accompanied with some sort of public pronouncement. Again, there is a sense in which this is true. Across the world, the ultra-rich have fled dense urban environments for the safety of their country, beach, farm and mountain compounds. How important it is, well, that’s another question. A situation at my son’s preschool is a good example. There’s a family there that is basically ultra-celebrity, next level kind of stuff, the kind of people that are instantly recognizable basically anywhere on Earth. And sure enough, the minute the COVID crisis hit they left the city, probably via private jet, and went to some compound ranch in big sky country.

But their story presents a couple of interesting points that challenge the narrative that there is some kind exodus going on. First, while this family “lived” in Los Angeles pre-COVID, they also lived in New York, London, Paris and various other places around the globe where they either routinely conduct business or own properties or both. There’s a mobility and fluidity to this lifestyle already built-in. Second, nothing has changed, at least not yet, in any permanent way to the underlying structure of the sports and entertainment world. The companies and studios are still concentrated in a few big cities and have announced no big changes on the horizon. This family will be back in LA for the simple reason that this is where deals and projects get done. To suggest that their

decision to wait out the crisis in the mountains means they are never coming back to LA is kind of ridiculous. The same is true even for those celebrities who have announced “they are never coming back.” They will be back.

Interestingly, in the pre-COVID world, there were structural problems with our economy already working to drive people out of big cities. One of the most important, least discussed was the problem of the geographic concentration of economic opportunity.

**Vitality Index by County**



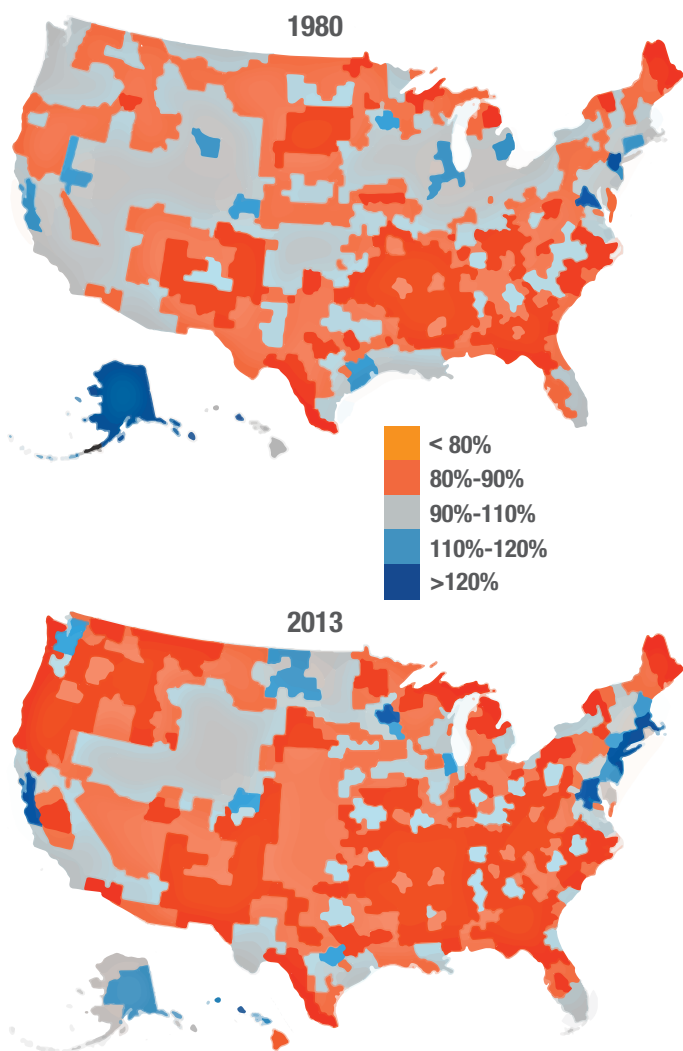
Source: American Community Survey (U.S. Census Bureau 2013-17); Institute for Health Metrics and Evaluation 2014; authors’ calculations.  
 Note: Yellow counties have below-average and blue counties have above-average vitality scores. darker counties have larger populations.

The data was clear. Most of the great opportunities—the real chances to make it in America, opportunities in technology, media and finance—were really only available in a handful of big city markets. It’s not that the cities were the only place to find opportunities. You could still make it in smaller cities and even the suburbs. But you had a much better chance in the cities. As a result, for the past 2 decades cities experienced an incredible resurgence and saw steady population growth. In recent years, the narrative was all about the city: the city as our greatest invention, the key to prosperity, the driver of economic growth. Books were coming out left and right about the triumph of the city.

But behind this rosy narrative something serious was happening that presented a real threat to the continued progress of the big cities. For what came along with all this resurgence was a serious inflation problem. This was the result of a sort

## Economic disparities across regions have grown over the past 40 years

Commuting Zone mean family income as a percentage of the national average. 1980 and 2013



Source: 1980 Decennial Census and 2011-2015 American Community Survey 5-year estimates, compiled by IPUMS USA <https://usa.ipums.org/usa>

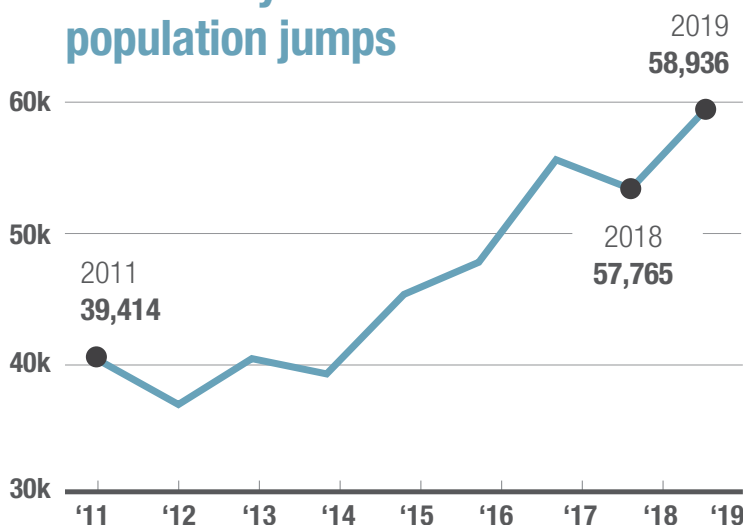
of perfect storm of contributing factors: the implications of the first rounds of Quantitative Easing, the resurgence of demand for urban living, decades of often racially motivated NIMBY housing policy, network effects in technology and media....All these were working together to drive people and money into urban real estate and prices had gone crazy. It's what happens when a bunch of demand enters a market of already-limited (often deliberately) supply.

In fact, housing price inflation had gotten so bad prior to the crisis that affordability was one of the most talked-about public policy issues of the day. Our biggest cities—places like LA, SF, NY and even Seattle—had become impossibly expensive and the big tech companies found themselves in the crosshairs

of some really bad press, so much so, that many of them announced enormous philanthropic financial pledges to help bring affordable housing to their cities and neighborhoods. And affordability wasn't the only problem, not at all. Amidst the apparent prosperity of the resurging cities, a dark force was spreading, seemingly inexorably, and darkening the horizon of optimism in our cities. Homelessness was raging out of control:

Homelessness had gotten so bad that people were starting to think of it as the humanitarian crisis of our time. It was a disheartening and highly visible sign that all was not well in the city.

## L.A. County homeless population jumps



Source: 1980 Decennial Census and 2011-2015 American Community Survey 5-year estimates, compiled by IPUMS USA <https://usa.ipums.org/usa>

As a result of all this, prior to the crisis, we were already seeing some out-migration from big cities. Places like Austin and Atlanta had started to become the cool new places for new economy emigres from SF, LA and NY. There was such a skew in the market for housing that for the price of a small condo in the big cities, you could get a massive home with a backyard and some space between you and your neighbors. If you had been in the cities, trading out was an incredible arbitrage in raw space. In exchange for this affordable housing, you give up the network effects and the diversity and dynamism of the city.

Despite this trend most of the cities were still seeing population growth pre-COVID. New York was the one notable exception which experienced population decline for the first time in many years in 2019—not a huge number by any means (something like 40K-50K people) but a decline nonetheless. It seems that what's happening today is that the COVID crisis has accelerated and intensified this moving-for-affordability trend. In my view, the question of whether the cities are dead turns on just how big this cohort really is. At this moment in

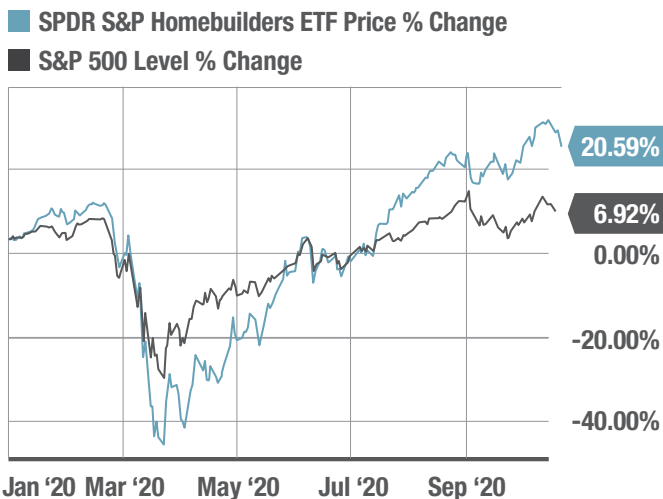
time, it's really hard to tell. I'm hearing two kinds of stories. There are those who say they are moving out for good and those who say this is just a temporary thing.

My own view is that the young people will be back and there's no need to worry about the ultra-rich. And the data on the moving-for-affordability (and space) cohort is just too mixed to make a good call right now. Even Zillow is finding that there is no clear trend in the data suggesting that Americans have given up on the cities. If you really want to get confused, read these stories from Redfin, Forbes, Fast Company and the Washington Post and then try to formulate an opinion about what's going on. And then, if you really want to get confused, read these reports from the New York Times on the coming migration due to climate change. The point is: it's basically impossible to discern the truth here.

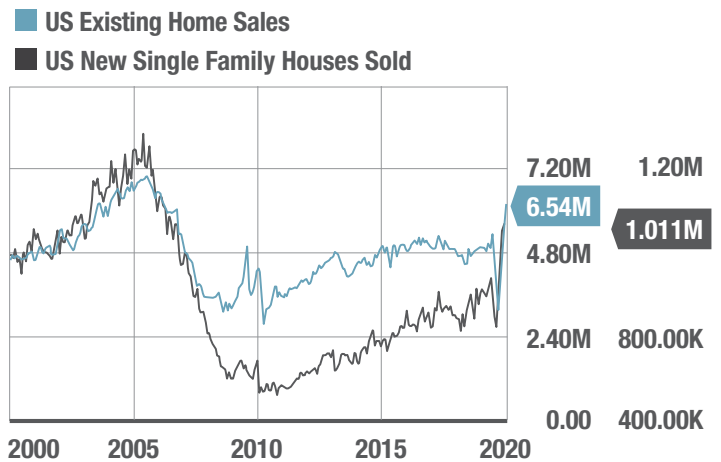
Here's what I do think though. The migration question almost doesn't matter when it comes to housing. What we know is that the demand for for-sale housing is back. People want to own again for all kinds of reasons. The desire for more space. Affordability. YOLO. FOMO. Whatever is going-on here, there's been a reawakening of the American Dream. This is why I think the housing boom is here to stay.

How can we take advantage of this insight?

I think there's a case to be made for investing in this thesis in the public markets. Homebuilding stocks have been outperforming the market since the summer and probably have a lot of room to run.



There's a huge amount pent-up demand in the system based on what's happened over the last decade in housing.



But as I discussed last month, given the overall macro picture and the potential for unusual outcomes, I'm not convinced the public markets are the place to be. In addition, I'm seeing a few macro market dynamics that could quickly and easily flip the bullish narrative for the big homebuilders. The first is, again, inflation. The Fed's extraordinary interventions in the capital markets have created this very pro-inflationary and pro-volatility environment. Look what's been happening in the lumber market for example:



This is a big negative to the perceived viability of the profit margin in home building. Secondly, in our projects at Metros Capital, we're seeing some serious signs of trouble in the supply chain for housing. Across the entire spectrum, in everything from raw building materials like wood to finished products like appliances, there are shortages and real delays. This too, if it persists, could eat away at the profit margins of the home builders.

Nick Halaris  
750 N. San Vicente Blvd.  
Suite 800 West  
West Hollywood, CA 90069

